

CRIMSON EXPLORATION INC.

Form 10-Q

November 16, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2009

OR

() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

for the transition period from to ____

Commission file number 000-21644

CRIMSON EXPLORATION INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation)

717 Texas Avenue, Suite 2900

20-3037840

(IRS Employer Identification No.)

77002

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Houston, Texas

(zip code)

(Address of principal executive offices)

(713) 236-7400

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

On November 10, 2009, there were 6,421,564 shares outstanding of the Registrant's Common Stock, par value \$0.001.

FORM 10-Q

CRIMSON EXPLORATION INC.

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PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****CRIMSON EXPLORATION INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****ASSETS**

	September 30, 2009 (unaudited)	December 31, 2008
CURRENT ASSETS		
Cash and cash equivalents	\$ —	\$ —
Accounts receivable, net of allowance	12,403,474	21,078,815
Prepaid expenses	3,849	77,293
Derivative instruments	17,121,267	25,191,445
Total current assets	29,528,590	46,347,553
PROPERTY AND EQUIPMENT		
Oil and gas properties (successful efforts method of accounting)	601,046,541	584,093,885
Other property and equipment	3,365,032	3,282,088
Accumulated depreciation, depletion and amortization	(179,175,724)	(138,220,237)
Total property and equipment, net	425,235,849	449,155,736
NONCURRENT ASSETS		
Deposits	104,697	104,697
Debt issuance cost, net	3,331,976	2,890,094
Deferred charges	—	1,324,907
Derivative instruments	4,279,665	11,722,802
Total noncurrent assets	7,716,338	16,042,500
TOTAL ASSETS	\$ 462,480,777	\$ 511,545,789
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Current portion of long-term debt	\$ 1,525,583	\$ 90,368
Accounts and revenues payable	20,513,642	47,726,858
Income taxes payable	341,851	546,944
Accrued liabilities	8,912,643	24,369,060
Asset retirement obligations	2,161,914	1,659,371
Derivative instruments	3,098,405	1,265,801
Deferred tax liability, net	4,839,599	8,331,208
Total current liabilities	41,393,637	83,989,610
NONCURRENT LIABILITIES		
Long-term debt, net of current portion	290,000,788	276,690,426
Asset retirement obligations	12,394,368	11,409,171
Derivative instruments	1,383,745	1,491,755
Deferred tax liability, net	10,051,928	15,609,315

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Other noncurrent liabilities	713,806	732,709
Total noncurrent liabilities	314,544,635	305,933,376
Total liabilities	355,938,272	389,922,986

COMMITMENTS AND CONTINGENCIES

STOCKHOLDERS' EQUITY

Preferred stock (see Note 7)	826	826
Common stock (see Note 7)	6,483	5,808
Additional paid-in capital	97,565,970	95,676,875
Retained earnings	9,352,931	26,189,888
Treasury stock (see Note 7)	(383,705)	(250,594)
Total stockholders' equity	106,542,505	121,622,803

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 462,480,777	\$ 511,545,789
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The Notes to Consolidated Financial Statements are an integral part of these statements.

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CRIMSON EXPLORATION INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
OPERATING REVENUES				
Natural gas sales	\$ 16,426,246	\$ 33,826,275	\$ 55,135,137	\$ 92,074,941
Crude oil sales	6,709,774	11,389,585	21,518,736	34,150,048
Natural gas liquids sales	3,616,522	7,901,683	9,089,086	24,687,092
Operating overhead and other income	147,862	634,248	508,249	889,142
Total operating revenues	26,900,404	53,751,791	86,251,208	151,801,223
OPERATING EXPENSES				
Lease operating expenses	3,879,621	5,653,989	13,517,664	15,362,455
Production and ad valorem taxes	1,563,460	4,819,558	6,060,579	14,355,289
Exploration expenses	687,613	1,044,499	2,873,255	1,877,382
Depreciation, depletion and amortization	13,400,031	13,159,886	41,599,314	36,029,611
Impairment of oil and gas properties	—	25,798,755	—	25,798,755
General and administrative	3,836,194	7,591,344	13,381,282	17,819,461
Loss (gain) on sale of assets	—	—	18,925	(15,271,712)
Total operating expenses	23,366,919	58,068,031	77,451,019	95,971,241
INCOME (LOSS) FROM OPERATIONS	3,533,485	(4,316,240)	8,800,189	55,829,982
OTHER (EXPENSE) INCOME				
Interest expense	(6,633,642)	(5,540,319)	(16,349,300)	(15,871,096)
Other financing cost	(382,159)	(339,480)	(1,109,805)	(1,174,013)
Unrealized gain (loss) on derivative instruments	(9,929,947)	88,901,338	(17,237,909)	1,664,541
Total other (expense) income	(16,945,748)	83,021,539	(34,697,014)	(15,380,568)
INCOME (LOSS) BEFORE INCOME TAXES	(13,412,263)	78,705,299	(25,896,825)	40,449,414
Income tax benefit (expense)	4,826,137	(28,461,407)	9,080,238	(15,104,519)
NET INCOME (LOSS)	(8,586,126)	50,243,892	(16,816,587)	25,344,895
Dividends on preferred stock	(1,156,163)	(1,083,328)	(3,353,150)	(3,164,111)
NET INCOME (LOSS) AVAILABLE TO COMMON SHAREHOLDERS	\$(9,742,289)	\$49,160,564	\$(20,169,737)	\$22,180,784
NET INCOME (LOSS) PER SHARE				
Basic	\$(1.51)\$9.19	\$(3.20)\$4.25
Diluted	\$(1.51)\$4.87	\$(3.20)\$2.46

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WEIGHTED AVERAGE SHARES OUTSTANDING

Basic	6,444,013	5,351,146	6,301,280	5,225,113
Diluted	6,444,013	10,317,629	6,301,280	10,289,138

The Notes to Consolidated Financial Statements are an integral part of these statements

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CRIMSON EXPLORATION INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2009

(UNAUDITED)

	NUMBER OF SHARES				ADDITIONAL	RETAINED	TREASURY	TOTAL
	PREFERRED STOCK	COMMON STOCK	PREFERRED STOCK	COMMON STOCK	PAID-IN CAPITAL	EARNINGS	STOCK	STOCKHOLDERS' EQUITY
BALANCE,								
DECEMBER 31, 2008	82,600	5,787,287	\$ 826	\$ 5,808	\$ 95,676,875	\$ 26,189,888	\$(250,594)	)\$ 121,622,803
Share-based compensation	—	668,690	—	669	1,868,731	—	—	1,869,400
Common stock issued as dividends on preferred stock	—	6,300	—	6	20,364	(20,370)) —	—
Current period net loss	—	—	—	—	—	(16,816,587)	) —	(16,816,587)
Treasury stock	—	(40,713)	) —	—	—	—	(133,111)	) (133,111)
BALANCE,								
SEPTEMBER 30, 2009	82,600	6,421,564	\$ 826	\$ 6,483	\$ 97,565,970	\$ 9,352,931	\$(383,705)	)\$ 106,542,505

The Notes to Consolidated Financial Statements are an integral part of these statements.

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CRIMSON EXPLORATION INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Nine Months Ended September 30,	
	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ (16,816,587	) \$ 25,344,895
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation, depletion and amortization	41,599,314	36,029,610
Settlement of asset retirement obligations	(361,239	) (421,600
Stock compensation expense	1,869,400	4,450,871
Amortization of debt issuance cost	945,313	833,556
Deferred charges	1,324,907	(718,768
Deferred income taxes (benefit)	(9,595,940	) 14,919,519
Dry holes, abandoned property, impaired assets	221,960	25,798,755
(Gain) loss on sale of assets	18,925	(15,271,712
Unrealized loss (gain) on derivative instruments	17,237,909	(1,664,541
Changes in operating assets and liabilities:		
Decrease in accounts receivable	8,675,339	1,986,366
(Increase) decrease in prepaid expenses	73,444	(201,562
Increase (decrease) in accounts payable and accrued liabilities	(42,440,824	) 5,823,502
Net cash provided by operating activities	2,751,921	96,908,891
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sale of assets	24,327	34,918,332
Capital expenditures	(16,545,051	) (82,577,152
Acquisition of oil and gas properties	493,532	(58,031,525
Deposits	—	(5,906
Net cash used in investing activities	(16,027,192	) (105,696,251
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of common stock options	—	346,500
Purchase of treasury stock	(133,111) —
Proceeds from debt	91,373,659	122,169,922
Payments on debt	(76,578,082	) (108,206,369
Debt issuance cost	(1,387,195) —
Net cash provided by financing activities	13,275,271	14,310,053
INCREASE IN CASH AND CASH EQUIVALENTS	—	5,522,693
CASH AND CASH EQUIVALENTS,		
Beginning of period	—	4,882,511
CASH AND CASH EQUIVALENTS,		
End of period	\$ —	\$ 10,405,204

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Cash paid for interest	\$ 14,484,741	\$ 17,378,802
Cash paid for income taxes	\$ 539,671	\$ 185,000

The Notes to Consolidated Financial Statements are an integral part of these statements.

CRIMSON EXPLORATION INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. ORGANIZATION AND NATURE OF OPERATIONS

Crimson Exploration Inc., together with its subsidiaries (“Crimson”, “we”, “our”, “us”), is an independent natural gas and crude oil company engaged in the acquisition, development, exploitation and exploration of natural gas and crude oil properties, primarily in the onshore U.S. Gulf Coast and South Texas regions.

2. BASIS OF PRESENTATION

Presentation –The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (“U.S.”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. The accompanying consolidated financial statements at September 30, 2009 (unaudited) and December 31, 2008 and for the three and nine months ended September 30, 2009 (unaudited) and 2008 (unaudited) contain all normally recurring adjustments considered necessary, in the opinion of management, for a fair presentation of our financial position, results of operations and cash flows for such periods. Operating results for the nine months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and accompanying notes included in our annual report on Form 10-K for the year ended December 31, 2008.

The accompanying financial statements include Crimson Exploration Inc. and its wholly-owned subsidiaries: Southern G Holdings, LLC, acquired May 8, 2007, and merged with Crimson Exploration Operating, Inc. on January 1, 2008, Crimson Exploration Operating, Inc., formed January 5, 2006 and LTW Pipeline Co., formed April 19, 1999. All material intercompany transactions and balances are eliminated upon consolidation. Certain reclassifications were made to previously reported amounts to make them consistent with the current presentation format.

Accounting Standards Codification — On July 1, 2009, the Financial Accounting Standards Board (“FASB”) instituted a new referencing system, which codifies, but does not amend, previously existing nongovernmental GAAP. The FASB *Accounting Standards Codification* (“ASC”) is now the single authoritative source for GAAP. Although the implementation of ASC had no impact on our financial statements, certain references to authoritative GAAP literature within our footnotes have been changed to cite the appropriate content within the ASC.

Adoption of ASU 2009-05 — In August 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2009-05, *Fair Value Measurement and Disclosures: Measuring Liabilities at Fair Value*. ASU 2009-05 provides clarification on measuring liabilities at fair value when a quoted price in an active market is not available. We adopted ASU No. 2009-05 (FASB ASC 820-10) as of September 30, 2009. The adoption of this statement did not have an impact on our financial position or results of operations.

Subsequent Events — We adopted the Financial Accounting Standards Board (“FASB”) Statement No. 165, “*Subsequent Events*”, which is now incorporated into ASC Topic No. 855 (“ASC 855”) as of June 30, 2009. ASC 855 requires entities to disclose the date through which they have evaluated subsequent events and whether the date corresponds with the release of their financial statements. The

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adoption of this statement did not have a material impact on our financial position or results of operations. We completed our review and analysis of potential subsequent events, as of November 16, 2009, the date these financial statements were issued. See Note 11- "Subsequent Events" for additional disclosures.

Interim Disclosures about Fair Value of Financial Instrument — We adopted FSP SFAS 107-1 and APB 28-1 "Interim Disclosures about Fair Value of Financial Instruments", which is now incorporated into ASC Topic No. 825 ("ASC 825") as of June 30, 2009. This statement increases the frequency of fair value disclosures to a quarterly instead of annual basis. The guidance relates to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet at fair value. The adoption of this statement did not have a material impact on our financial position or results of operations.

Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly — We adopted the FSP SFAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" which is now incorporated into ASC Topic No. 820 ("ASC 820") as of June 30, 2009. ASC 820 provides guidelines for a broad interpretation of when to apply market-based fair value measures. It reaffirms management's need to use judgment to determine when a market that was once active has become inactive and in determining fair values in markets that are no longer active.

Disclosure about Derivative Instruments and Hedging Activities — We adopted FASB Statement No. 161, "Disclosure about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" which is now incorporated into ASC Topic No. 815 ("ASC 815") as of January 1, 2009. ASC 815 amends and expands the disclosure requirements for derivative instruments and hedging activities with the intent to provide users of financial statements with an enhanced understanding of: (i) how and why an entity uses derivative instruments; (ii) how derivative instruments and related hedged items are accounted for; and (iii) how derivative instruments and related hedged items affect an entity's financial position, results of operations and cash flows. See Note 5 – "Derivative Instruments" for these additional disclosures. The adoption of this statement did not have an impact on our financial position or results of operations.

Business Combinations — We adopted SFAS No. 141 (Revised 2007) "Business Combinations" which is now incorporated into ASC Topic No. 805 ("ASC 805") as of January 1, 2009. The revision broadens the definition of a business combination to include all transactions or other events in which control of one or more businesses is obtained. Further, this statement establishes principles and requirements for how an acquirer recognizes assets acquired, liabilities assumed and any non-controlling interests acquired. The adoption of this statement has not had an impact on our financial position or results of operations, because we have not yet had any business combinations in 2009.

Effective Date of FASB Statement No. 157 - We also adopted FSP SFAS 157-2, "Effective Date of FASB Statement No. 157", which is also now incorporated into ASC Topic No. 820 as of January 1, 2009. The effective date was deferred for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually) to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years. See Note 4 – "Fair Value Measurements" for additional disclosures. The adoption of this statement did not have a material impact on our financial position or results of operations.

3. OIL AND GAS PROPERTIES

Acquisition from Smith Production Inc.

In May 2008, we acquired four producing gas fields and undeveloped acreage in South Texas from Smith Production Inc. ("Smith") for a purchase price of \$65.0 million with an economic effective date of

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January 1, 2008. After adjustment for the estimated results of operations, and other typical purchase price adjustments of approximately \$7.4 million for the period between the effective date and the closing date, the cash consideration was approximately \$57.6 million.

Fort Worth Barnett Shale Disposition

In January 2008, we and our operator-partner entered into a series of agreements to sell our interests in wells and undeveloped acreage in the Fort Worth Barnett Shale Play in Johnson and Tarrant counties, Texas to another industry participant active in that area. We owned a 12.5% non-operated working interest in the assets being sold and had 1.5 Bcfe in proved reserves at December 31, 2007. The final total consideration paid by the buyer was based on existing wells and undeveloped acreage owned by us and our partner at the time of the final closing. Our share of the consideration received was approximately \$34.4 million. Proceeds received for our interest were primarily used to repay amounts outstanding under our senior secured revolving credit facility and to help finance our acquisition of the properties from Smith. Our net book value of these assets sold was \$18.8 million, which resulted in a gain of \$15.6 million.

4. FAIR VALUE MEASUREMENTS

We use a fair value hierarchy which prioritizes the inputs to valuation techniques for measuring fair value into three levels. The fair value hierarchy gives the highest priority to quoted market prices (unadjusted) in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs are inputs, other than quoted prices included within Level 1, which are observable for the asset or liability, either directly or indirectly. We use Level 1 inputs when available, as Level 1 inputs generally provide the most reliable evidence of fair value.

Certain of our assets and liabilities are reported at fair value in our consolidated balance sheets. The following methods and assumptions were used to estimate the fair values for each class of financial instruments:

Cash, Cash Equivalents, Accounts Receivable and Accounts Payable. The carrying amounts approximate fair value due to the short-term nature or maturity of the instruments. Our allowance for doubtful accounts as of September 30, 2009 and December 31, 2008 remains at \$0.2 million.

Derivative Instruments. Our derivative instruments consist of variable to fixed price commodity swaps, costless collars and interest rate swaps. We value our derivative instruments utilizing estimates of present value as calculated by the respective counterparty financial institutions and reviewed by management. See Note 5 – “Derivative Instruments” for further information. Fair value information for assets and liabilities that are measured at fair value is as follows at September 30, 2009:

	Total Carrying Value	Fair Value Measurements Using Level 1	Level 2	Level 3
Derivatives				
Crude oil & natural gas swaps	\$ 752,273	\$—	\$752,273	\$—
Crude oil & natural gas collars	21,400,932	—	21,400,932	—
Interest rate swaps	(5,234,423)	—	(5,234,423)	—
Totals	\$ 16,918,782	\$—	\$16,918,782	\$—

Asset Impairments – We review a proved oil and gas property for impairment when events and circumstances indicate a significant decline in the recoverability of the carrying value of such property. If events indicate a significant decline in the recoverability of such property, we estimate the future cash flows expected in connection with the property and compare such future cash flows to the carrying amount of the property to determine if the carrying amount is recoverable. If the carrying amount of the

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property exceeds its estimated undiscounted future cash flows, the carrying amount of the property is reduced to its estimated fair value. Fair value may be estimated using comparable market data, a discounted cash flow method, or a combination of the two. In the discounted cash flow method, estimated future cash flows are based on management's expectations for the future and include estimates of future oil and gas production, commodity prices based on commodity futures price strips as of the date of the estimate, operating and development costs, and a risk-adjusted discount rate. We had no asset impairments in the nine months ended September 30, 2009.

Debt—The fair value of debt approximates the carrying amounts on such debt. Interest rates are based on Prime or LIBOR rates at the time the loans are renewed. See Note 6 – “Debt” for further information.

Asset Retirement Obligations—We estimate the fair values of asset retirement obligations (“AROs”) based on discounted cash flow projections using numerous estimates, assumptions and judgments regarding such factors as the existence of a legal obligation for an ARO; estimated probabilities, amounts and timing of settlements; the credit-adjusted risk-free rate to be used; and inflation rates.

	Total Carrying Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Asset retirement obligations	\$ 14,556,282	\$ —	\$ —	\$ 14,556,282

Asset Retirement Obligations Rollforward

Beginning January 1, 2009 liability	\$ 13,068,542
Additions	103,691
Accretion	643,825
Revisions	1,112,951
Properties sold	(11,488)
Plugging and abandonment activity	(361,239)
Ending September 30, 2009 liability	\$ 14,556,282

5. DERIVATIVE INSTRUMENTS

In the past we have entered into, and may in the future enter into, certain derivative arrangements with respect to portions of our natural gas and crude oil production, to reduce our sensitivity to volatile commodity prices, and with respect to portions of our debt, to reduce our sensitivity to volatile interest rates. None of our derivative instruments are designated as cash flow hedges. We believe that these derivative arrangements, although not free of risk, allow us to achieve a more predictable cash flow and to reduce exposure to commodity price and interest rate fluctuations. However, derivative arrangements limit the benefit of increases in the prices of natural gas, crude oil and natural gas liquids sales and limit the benefit of decreases in interest rates. Moreover, our derivative arrangements apply only to a portion of our production and our debt and provide only partial protection against declines in commodity prices and increases in interest rates, respectively. Such arrangements may expose us to risk of financial loss in certain circumstances. We continuously reevaluate our hedging programs in light of changes in production, market conditions, commodity price forecasts, capital spending, interest rate forecasts and debt service requirements.

We use a mix of commodity swaps and costless collars and interest rate swaps to accomplish our hedging strategy. Derivative assets and liabilities with the same counterparty, subject to contractual terms which provides for net settlement, are reported on a net basis on our consolidated balance sheets. We have exposure to financial institutions in the form of derivative transactions in connection with our hedges. These transactions are with counterparties in the financial services industry specifically with

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members of our bank group. These transactions could expose us to credit risk in the event of default of our counterparties. In addition, if any lender under our credit facility is unable to fund its commitment, our liquidity could be reduced by an amount up to the aggregate amount of such lender's commitment under our credit facility. We believe our counterparty risk is low because of the offsetting relationship we have with each of our counterparties. See Note 4 — "Fair Value Measurements" for further information.

The following derivative contracts were in place at September 30, 2009:

Crude Oil		Volume/Month	Price/Unit	Fair Value	
Oct 2009-Dec 2009	Swap	5,200 Bbls	\$74.20	\$48,808	
Oct 2009-Dec 2009	Collar	12,800 Bbls	\$66.55-\$71.40	(62,354)
Oct 2009-Dec 2009	Collar	10,733 Bbls ⁽¹⁾	\$115.00-\$171.50	1,414,607	
Jan 2010-Dec 2010	Swap	4,250 Bbls	\$72.32	(104,180)
Jan 2010-Dec 2010	Collar	9,000 Bbls	\$65.28-\$70.60	(627,041)
Jan 2010-Dec 2010	Collar	7,604 Bbls ⁽¹⁾	\$110.00-\$181.25	3,398,019	
Jan 2011-Dec 2011	Swap	3,300 Bbls	\$70.74	(257,729)
Jan 2011-Dec 2011	Collar	7,000 Bbls	\$64.50-\$69.50	(807,512)
Natural Gas					
Oct 2009-Dec 2009	Swap	36,000 Mmbtu	\$8.32	386,563	
Oct 2009-Dec 2009	Collar	475,000 Mmbtu	\$7.90-\$9.45	4,388,271	
Oct 2009-Dec 2009	Collar	101,200 Mmbtu ⁽¹⁾	\$9.50-\$18.70	1,417,191	
Jan 2010-Jun 2010	Swap	45,833 Mmbtu ⁽¹⁾	\$6.25 ⁽²⁾	93,545	
Jan 2010-Dec 2010	Swap	29,000 Mmbtu	\$7.88	585,266	
Jan 2010-Dec 2010	Collar	351,000 Mmbtu	\$7.57-\$9.05	6,666,180	
Jan 2010-Dec 2010	Collar	85,167 Mmbtu ⁽¹⁾	\$9.00-\$15.25	3,065,348	
Jan 2011-Dec 2011	Collar	266,000 Mmbtu	\$7.32-\$8.70	2,548,223	
Interest rate		Notional Amount	Fixed LIBOR Rate		
Oct 2009-Dec 2010	Swap	\$50,000,000	1.50%	(500,319)
Oct 2009- May 2011	Swap	\$150,000,000	2.90%	(4,734,104)
Total net fair value asset of derivative instruments				\$ 16,918,782	

⁽¹⁾ Average volume per month for the remaining contract term

⁽²⁾ Average price for the contract term

The total net fair value asset for derivative instruments at September 30, 2009 was approximately \$16.9 million and at December 31, 2008 was approximately \$34.2 million, which are shown as derivative instruments in assets and liabilities on the balance sheet.

The following table details the effect of derivative contracts on the Consolidated Statements of Operations:

Contract Type	Location of Gain or (Loss) Recognized in Income	Amount of Gain or (Loss) Recognized in Income			
		Three months ended		Nine months ended	
		September 30,		September 30,	
		2009	2008	2009	2008

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Commodity prices	Operating revenues	\$ 10,368,926	\$ (5,712,364)	\$ 30,809,560	\$ (13,230,982)
Interest rate	Interest expense	(1,158,810)	(1,304,933)	(3,242,533)	(2,783,796)
	Realized gain (loss)	\$ 9,210,116	\$ (7,017,298)	\$ 27,567,027	\$ (16,014,779)
Commodity prices	Other income (expense)	\$ (9,585,588)	\$ 87,380,831	\$ (17,689,012)	\$ 752,333
Interest rates	Other income (expense)	(344,359)	1,520,507	451,103	912,208
	Unrealized gain (loss)	\$ (9,929,947)	\$ 88,901,338	\$ (17,237,909)	\$ 1,664,541

6. DEBT

On November 6, 2009, we entered into a second and third amendment to our senior secured revolving credit facility, dated May 31, 2007, as amended ("*Senior Credit Agreement*"). This facility provides cash availability for acquisitions of oil and gas properties and for general corporate cash requirements. The Senior Credit Agreement provides for aggregate borrowings of up to \$400.0 million, with an initial borrowing base of \$200.0 million that decreased to \$140.0 million, effective November 2, 2009, and is subject to semi-annual redeterminations, although our lenders may elect to make one additional redetermination between scheduled redetermination dates (and have expressly reserved the right to do so between January 1, 2010 and May 1, 2010). The next borrowing base redetermination is scheduled for January 1, 2010. These amendments to the Senior Credit Agreement provide, among other things, for (i) a change in the voting percentages required for certain amendments or waivers from 50.1% to 60%, and (ii) a waiver of the current ratio and the leverage ratio for the quarter ended September 30, 2009. The Senior Credit Agreement matures on May 8, 2011. As of September 30, 2009, we had an outstanding loan balance of \$141.5 million under our Senior Credit Agreement.

Also, on November 6, 2009, we issued an unsecured promissory note in an aggregate principal amount of \$10.0 million to Wells Fargo Bank, National Association, the administrative agent and a lender under our Senior Credit Agreement. This promissory note bears interest at a per annum rate equal to two-month LIBOR plus 2% and matures on January 15, 2010; provided that upon an event of default resulting from the failure to make any payment of principal or interest under the promissory note, the interest rate per annum will increase to an amount equal to the lesser of the maximum rate of interest that may be charged under applicable law and LIBOR plus 4% or, if the promissory note has been assigned to any person other than any affiliate of Wells Fargo Bank, LIBOR plus 15%. All of the proceeds of the promissory note were used to repay indebtedness outstanding under the Senior Credit Agreement. As support for the obligations owed under the promissory note, OCM GW Holdings, LLC ("*Oaktree Holdings*"), our majority stockholder, has deposited \$10.0 million in escrow for the benefit of Wells Fargo, which may, at its option, cause the note to be assigned to Oaktree Holdings and draw on the funds held in escrow.

As consideration for Oaktree Holdings' agreement to deposit \$10.0 million in escrow as described above, we issued an unsecured subordinated promissory note on November 6, 2009 in an aggregate principal amount of \$2.0 million to Oaktree Holdings. The indebtedness under the promissory note bears interest at a rate equal to 8.0% per annum and matures on the later of (i) November 8, 2012 and (ii) the date six months after payment in full in cash of all Obligations (as such term is defined under each of the Senior Credit Agreement and the Second Lien Credit Agreement (defined below)), and the termination of all commitments to extend credit under the Senior Credit Agreement and the Second Lien Credit Agreement. The promissory note is subordinated in right of payment to the prior payment in full in cash of all obligations under the Senior Credit Agreement and the Second Lien Credit Agreement.

On July 31, 2009, we entered into the first amendment to our Senior Credit Agreement. This amendment to the Senior Credit Agreement provides, among other things, for (i) the leverage ratio to be not greater than 2.75 to 1.00 for each fiscal quarter, (ii) the current ratio to be not less than 1.00 to 1.00 for each fiscal quarter, (iii) an increased applicable margin on LIBOR loans to between 2.75% and 3.50%, and base rate loans to between 1.50% and 2.00%, depending on the percent of the borrowing base utilized at the time of the credit extension, and (iv) an increased commitment fee on unutilized commitments to 0.50%.

On November 6, 2009, we entered into a third amendment and waiver to our second lien credit agreement dated May 8, 2007, as amended (the "*Second Lien Credit Agreement*"), with lenders holding a majority of the then outstanding term loans under such agreement, which included an affiliate of Oaktree Holdings. The Second Lien Credit Agreement provides for a term loan in an aggregate principal amount

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of \$150.0 million, with a term of five years with all principal amounts, together with all accrued and unpaid interest, due and payable in full on May 8, 2012. The third amendment to our Second Lien Credit Agreement provided, among other things, for a waiver of the leverage ratio covenant for the quarter ended September 30, 2009.

The Senior Credit Agreement and the Second Lien Credit Agreement (the “*Credit Agreements*”) are secured by a lien on substantially all of our assets, as well as a security interest in the stock of our subsidiaries. The obligations under the Second Lien Credit Agreement are junior to those under the Senior Credit Agreement. Interest is payable on the Credit Agreements as borrowings mature and renew.

The Credit Agreements include usual and customary affirmative covenants for credit facilities of the respective types and sizes, as well as customary negative covenants, including, among others, limitations on liens, hedging, mergers, asset sales or dispositions, payments of dividends, incurrence of additional indebtedness, certain leases and investments outside of the ordinary course of business, as well as events of default. The Credit Agreements also contain certain financial and proved reserve covenants. See Note 10 of our 2008 Annual Report on Form 10-K for a more detailed description of our covenants under the Credit Agreements, other than those revised above. At September 30, 2009, we were in compliance with the aforementioned covenants, with the exception of the current ratio under the Senior Credit Agreement and the leverage ratio under both of the Credit Agreements. We obtained waivers of such noncompliance from our lenders under the Credit Agreements for the quarter ended September 30, 2009. However, without improvement in natural gas and crude oil prices, reduction in debt levels, improvement in production volumes and/or other measures, we may not be able to comply with certain covenants under our Credit Agreements for future quarters. We continue to pursue other public and private sources of capital which would positively affect our debt covenant ratios and we continue to work with our lenders on long term amendments to our covenants. If we are unable to comply with the covenants for future quarters, we believe that it is not probable that we would not be able to cure future covenant violations by obtaining additional capital or by obtaining waivers from our lenders to cure the defaults, although we can give no assurances that any such sources of capital will be available or that such amendments will be entered into, or on terms acceptable to us. If we were not able to comply with our covenants in the future, and we were not able to obtain waivers from our lenders to cure such defaults, our lenders would have the right to demand acceleration of payment on all amounts outstanding under our Credit Agreements.

7. STOCKHOLDERS' EQUITY

In the nine months ended September 30, 2009, we issued approximately 0.6 million shares of common stock, par value \$0.001 per share ("*Common Stock*") subject to restricted stock awards to our employees under the performance-based Long-Term Incentive Plan ("*LTIP*") for the 2008 plan year. We issued 48,586 shares of restricted stock to two members of our board of directors as compensation pursuant to the Director Compensation Plan. We also issued 6,300 shares of Common Stock in payment of dividends on Series H Preferred Stock valued at \$20,370 based on the closing market price on the date the shares were issued. As a result of the vesting of 124,169 shares of restricted Common Stock, 40,713 shares of such stock were withheld by us to satisfy the employees' withholding tax liability, as provided for in the restricted stock agreements, with the remaining shares being released to the associated employees.

	September 30, 2009	December 31, 2008
<u><i>Preferred Stock</i></u>		
Series G, par value \$0.01; 81,000 shares authorized; 80,500 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	\$ 805	\$ 805
Series H, par value \$0.01; 6,500 shares authorized; 2,100 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively	21 \$ 826	21 \$ 826
<u><i>Common Stock</i></u>		
Par value \$0.001; 200,000,000 shares authorized; 6,421,564 and 5,787,287 shares issued and outstanding – net of treasury shares at September 30, 2009 and December 31, 2008, respectively	\$ 6,483	\$ 5,808
<u><i>Treasury Stock</i></u>		
At cost, 61,338 and 20,625 shares at September 30, 2009 and December 31, 2008, respectively	\$ (383,705	) \$ (250,594)

The following table sets forth the accumulated value of undeclared dividends on our preferred stock at September 30, 2009 and December 31, 2008, respectively:

	September 30, 2009	December 31, 2008
Series G Preferred Stock	\$ 17,679,445	\$ 14,365,860
Series H Preferred Stock	6,790	9,380
	\$ 17,706,235	\$ 14,375,240

Until such time as the Board of Directors declares and pays dividends on our Series G Preferred Stock, dividends shall continue to accumulate. Dividends on our Series H Preferred Stock are declared quarterly by our Board of Directors, and are paid out in Common Stock the following quarter.

8. SHARE-BASED COMPENSATION

We have share-based compensation for employees and directors, which includes both stock option and restricted stock awards. The following table reflects share-based compensation expense, assuming a 35.0% effective tax rate for the periods ended:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Share-based compensation expense, net of tax of \$121,594 and \$507,701, and \$654,290 and \$1,513,904, respectively	\$ 225,817	\$ 942,874	\$ 1,215,110	\$ 2,811,537
Basic earnings per share impact	\$ (0.04	) \$ (0.18	) \$ (0.19	) \$ (0.54
Diluted earnings per share impact	\$ (0.04	) \$ (0.09	) \$ (0.19	) \$ (0.27

In the nine months ended September 30, 2009, we awarded approximately 0.6 million shares of restricted Common Stock and 0.5 million shares in stock options to our employees under our LTIP for the 2008 plan year. We also issued 48,586 shares of restricted Common Stock to two members of our board of directors as compensation pursuant to the Director Compensation Plan.

In the nine months ended September 30, 2008, we issued 1,538 shares of restricted Common Stock to two members of our board of directors as compensation pursuant to the Director Compensation Plan. We also issued 533,350 shares of unvested Common Stock pursuant to restricted stock awards in exchange for the forfeiture of 1,066,700 substantially vested stock option grants. The fair value of the unvested Common Stock was calculated as \$4.9 million on the issuance date. The fair value of the forfeited stock options, calculated using the Black-Scholes valuation model, was \$4.3 million immediately prior to the forfeiture. The sum of the incremental value of the new award over the forfeited options, \$0.6 million, and the unrecognized compensation cost for the original award as of the exchange date, \$1.4 million, are being amortized using the straight line method over the new vesting period of five years, or approximately \$32,000 a month.

9. INCOME TAXES

Income tax benefit for the nine months ended September 30, 2009 was \$9.1 million, compared to income tax expense of \$15.1 million for the nine months ended September 30, 2008. The income tax benefit for the nine months ended September 30, 2009 was based on our estimate of the effective tax rate expected to be applicable for the full year. The effective tax rate and the federal statutory rate were 35% for the nine months ended September 30, 2009.

10. RECENT ACCOUNTING PRONOUNCEMENTS

SEC 33-8995/34-59192. In December 2008, the SEC adopted Release No. 33-8995/34-59192, "Modernization of Oil and Gas Reporting" ("SEC 33-8995"). This release amends the oil and gas reporting disclosures that exist in their current form in Regulation S-K and Regulation S-X under the Securities Act of 1933 and the Securities Exchange Act of 1934 to provide investors with a more meaningful and comprehensive understanding of oil and gas reserves. The new rules include changes for pricing used to estimate reserves; permitting disclosure of possible and probable reserves; ability to include non-traditional resources in reserves and the use of new technology for determining reserves. SEC 33-8995 is effective for fiscal years ending on or after December 31, 2009. Early adoption is not

permitted. We are currently evaluating the provisions of SEC 33-8995 and assessing the impact it may have on our financial reporting disclosures.

11. SUBSEQUENT EVENTS

On November 6, 2009, we completed the second and third amendments to our Senior Credit Agreement, which changed the voting requirements for certain amendments or waivers and waived certain covenants for the quarter ended September 30, 2009. We also issued a \$10.0 million promissory note with Wells Fargo Bank and a \$2.0 million subordinated promissory note with Oaktree Holdings.

On November 6, 2009, we completed the third amendment to our Second Lien Credit Agreement, which waived the leverage ratio for the quarter ended September 30, 2009.

For a complete description of these events, see Note 6 – “Debt”.

ITEM MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

2.

CONDITION AND RESULTS OF OPERATIONS

Forward-looking statements

The following discussion should be read in conjunction with the consolidated financial statements and the notes thereto included in this quarterly report on Form 10-Q and with the consolidated financial statements, notes and management's discussion and analysis reported on our 2008 Annual Report on Form 10-K. Statements in this discussion may be forward-looking. These forward-looking statements involve risks and uncertainties. There have been no material changes in the risk factors set forth in our 2008 Annual Report on Form 10-K.

These forward-looking statements include, but are not limited to, statements regarding:

- estimates of proved reserve quantities and net present values of those reserves;
- estimates of probable and possible reserve quantities;
- reserve potential;
- business strategy;
- estimates of future commodity prices;
- amounts and types of capital expenditures and operating expenses;
- expansion and growth of our business and operations;
- expansion and development trends of the oil and natural gas industry;
- acquisitions of oil and natural gas properties;
- production of oil and natural gas reserves;
- exploration prospects;
- wells to be drilled, and drilling results;
- operating results and working capital; and
- future methods and types of financing.

We caution that a number of factors could cause future production, revenues and expenses to differ materially from our expectations. For a discussion on risk factors affecting our business, see the information in "ITEM 1A. Risk Factors" contained in our most recent Annual Report filed on Form 10-K with the Securities and Exchange Commission.

Overview

We are an independent energy company engaged in the acquisition, development, exploitation and exploration of natural gas and crude oil properties. We have historically focused our operations in the onshore U.S. Gulf Coast and South Texas regions. In late 2008 and early 2009, we acquired approximately 12,000 net acres in the Haynesville Shale/Bossier/James Lime play in East Texas, which we refer to as our East Texas resource plays. In 2009, we acquired approximately 2,800 net acres in the Edwards Trend in South Texas. Our focus is on growing our reserves and production by further exploiting our existing property base, through drilling opportunities identified in our new resource plays and our conventional inventory, and by opportunistic acquisitions of underdeveloped properties, including

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leaseholds, in areas where we have specific operating expertise. Our gross revenues are derived from the following sources:

1. Natural gas, crude oil and natural gas liquids sales that are proceeds from the sale of natural gas, crude oil and natural gas liquids production, inclusive of our settled hedges. This represents over 99% of our gross revenues.
2. Operating overhead and other income that consists primarily of administrative fees received for operating natural gas and crude oil properties for other working interest owners and for marketing and transporting natural gas for those owners.

Recent Developments

East Texas Acreage Acquisition

In the second half of 2008 and early 2009, we obtained natural gas and crude oil leases from mineral interest owners covering approximately 17,000 gross (12,000 net) acres in the natural gas resource play in East Texas specifically in San Augustine, Sabine and Shelby Counties. We commenced our first well (the Kardell #1H), in which we owned a 52% working interest, in this play in late June 2009 and completed that well in October. The well was a successful test of the Haynesville Shale formation, which has a total measured depth of approximately 18,350 feet. The initial 24-hour production experienced from the Kardell #1H well in early November 2009 was 30.7 MMcfe/d (12.0 MMcfe/d to our interest). However, initial production rates in the Haynesville Shale tend to decline steeply in the first 12 months of production and are not necessarily indicative of sustained production rates. We plan to continue to pursue an active drilling program in this area for the next several years, targeting primarily the Haynesville Shale, the mid-Bossier and the James Lime formations. We financed this acquisition with cash flows from operations and from borrowings available under our revolving credit facility.

Smith Acquisition

In May 2008, we acquired four producing gas fields and undeveloped acreage in South Texas from Smith Production Inc. (“Smith”) for a purchase price of \$65.0 million with an economic effective date of January 1, 2008. After adjustment for the estimated results of operations, and other typical purchase price adjustments of approximately \$7.4 million for the period between the effective date and the closing date, the cash consideration was approximately \$57.6 million.

Barnett Shale Disposition

In January 2008, we and our operator-partner entered into a series of agreements to sell our interests in wells and undeveloped acreage in the Fort Worth Barnett Shale Play in Johnson and Tarrant counties, Texas to another industry participant active in that area. We owned a 12.5% non-operated working interest in the assets being sold and had 1.5 Bcfe in proved reserves at December 31, 2007. The total consideration paid by the buyer was based on existing wells and undeveloped acreage owned by us and our partner at the time of the final closing. Our share of the consideration received was approximately \$34.4 million. Proceeds received for our interest were primarily used to repay amounts outstanding under our senior revolving credit facility and to help finance our acquisition of the properties from Smith. Our net book value of the assets sold was \$18.8 million, which resulted in a gain of \$15.6 million.

Promissory Notes

On November 6, 2009 we issued an unsecured promissory note in the aggregate principal amount of \$10.0 million to Wells Fargo Bank, National Association and an unsecured subordinated promissory note in the aggregate principal amount of \$2.0 million to our majority stockholder. See Note 6 – “Debt” to Consolidated Financial Statements and “—Liquidity and Capital Resources—Capital Resources.”

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Results of Operations

The following is a discussion of our consolidated results of operations, financial condition and capital resources. You should read this discussion in conjunction with our Consolidated Financial Statements and the Notes thereto contained elsewhere in this Form 10-Q.

Comparative results of operations for the periods indicated are discussed below.

Three Months Ended September 30, 2009 Compared to Three Months Ended September 30, 2008

Revenues

	Three months ended September 30,				
	2009	2008	Change		Percent Change
	(in millions, except percentages)				
Revenues:					
Natural gas sales	\$ 16.4	\$ 33.8	\$(17.4)	)	-51.5%
Crude oil sales	6.7	11.4	(4.7)	)	-41.2%
Natural gas liquids sales	3.6	7.9	(4.3)	)	-54.4%
Product revenues	\$ 26.7	\$ 53.1	\$(26.4)	)	-49.7%

Natural Gas, Crude Oil And Natural Gas Liquids Sales. Revenues from the sale of crude oil, natural gas and natural gas liquids, net of the realized effects of our hedging instruments, were \$26.7 million for the third quarter 2009 compared to \$53.1 million for the third quarter 2008 due to an approximate 29% decrease in production and an approximate 29% decline in realized commodity prices.

	Three months ended September 30,				
	2009	2008	Change		Percent Change
Sales (production) volumes:					
Natural gas (Mcf)	2,373,940	3,494,392	(1,120,452)	)	-32.1%
Crude oil (Bbl)	76,376	123,080	(46,704)	)	-37.9%
Natural gas liquids (Bbl)	114,792	124,460	(9,668)	)	-7.8%
Natural gas equivalents (Mcfe)	3,520,948	4,979,632	(1,458,684)	)	-29.3%

Quarterly production was approximately 3.5 Bcfe for the third quarter 2009 compared to approximately 5.0 Bcfe for the third quarter 2008. On a daily basis, we produced an average of 38,271 Mcfe for the third quarter 2009 compared to an average of 54,126 Mcfe for the third quarter 2008. Production volumes decreased primarily due to natural field decline and limited production-enhancing capital expenditure activity during 2009. However, we did have approximately 364,000 mcfe of lost production and natural gas liquids not processed due to Hurricanes Gustav and Ike in the third quarter 2008.

	Three months ended September 30,				
	2009	2008	Change		Percent Change
Average sales prices (after hedging):					
Natural gas (Mcf)	\$ 6.92	\$ 9.68	\$(2.76)	)	-28.5%
Crude oil (Bbl)	87.85	92.54	(4.69)	)	-5.1%
Natural gas liquids (Bbl)	31.51	63.49	(31.98)	)	-50.4%
Natural gas equivalents (Mcfe)	7.60	10.67	(3.07)	)	-28.8%

	Three months ended September 30,			Percent
	2009	2008	Change	Change
Average sales prices (before hedging):				
Natural gas (Mcf)	\$ 3.24	\$ 10.32	\$ (7.08)	) -68.6%
Crude oil (Bbl)	66.57	120.88	(54.31)	) -44.9%
Natural gas liquids (Bbl)	31.51	63.49	(31.98)	) -50.4%
Natural gas equivalents (Mcf)	4.65	11.81	(7.16)	) -60.6%

Natural gas, crude oil and natural gas liquids prices are reported net of the realized effect of our hedging agreements. We realized gains of \$1.6 million on our crude oil hedges and \$8.8 million on our natural gas hedges in the third quarter 2009, compared to realized losses of \$3.5 million for crude oil hedges and \$2.2 million for natural gas hedges in the third quarter 2008.

Costs and Expenses

	Three months ended September 30,			Percent
	2009	2008	Change	Change
	(in millions, except percentages)			
Certain Operating Expenses:				
Lease operating expenses	\$ 3.9	\$ 5.7	\$ (1.8)	) -31.6%
Production and ad valorem taxes	1.6	4.8	(3.2)	) -66.7%
Exploration expenses	0.7	1.0	(0.3)	) -30.0%
General and administrative ⁽¹⁾	3.5	6.1	(2.6)	) -42.6%
Operating expenses (cash)	9.7	17.6	(7.9)	) -44.9%
Depreciation, depletion & amortization	13.4	13.2	0.2	1.5%
Share-based compensation ⁽¹⁾	0.3	1.5	(1.2)	) -80.0%
Certain operating expenses ⁽²⁾	\$ 23.4	\$ 32.3	\$ (8.9)	) -27.6%

(1) Total general and administrative costs include share-based compensation on the Consolidated Statements of Operations.

(2) Exclusive of impairments and sales.

	Three months ended September 30,			Percent
	2009	2008	Change	Change
	(in millions, except percentages)			
Selected Costs (\$ per Mcfe):				
Lease operating expenses	\$ 1.10	\$ 1.14	\$ (0.04)	) -3.5%
Production and ad valorem taxes	0.44	0.97	(0.53)	) -54.6%
Exploration expenses	0.20	0.21	(0.01)	) -4.8%
General and administrative ⁽¹⁾	0.99	1.23	(0.24)	) -19.5%
Operating expenses (cash)	2.73	3.55	(0.82)	) -23.1%
Depreciation, depletion & amortization	3.81	2.64	1.17	44.3%
Share-based compensation ⁽¹⁾	0.10	0.29	(0.19)) -65.5%

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Selected costs	\$ 6.64	\$ 6.48	\$ 0.16	2.5%
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(1) Total general and administrative costs include share-based compensation on the Consolidated Statements of Operations.

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Lease Operating Expenses. Lease operating expenses for the third quarter 2009 were \$3.9 million, compared to \$5.7 million in the third quarter 2008, a decrease resulting from the implementation of cost reduction initiatives during 2009 in response to the lower commodity price environment.

Production and Ad Valorem Tax Expenses. Production and ad valorem tax expenses for the third quarter 2009 were \$1.6 million, compared to \$4.8 million for the third quarter 2008, due to lower production and lower realized prices in 2009 and state tax credits, net to us, of \$0.4 million as a result of our focus on maximizing allowable deductions and opportunities for tax relief for prior periods.

Exploration Expenses. Exploration expenses were \$0.7 million in the third quarter 2009 compared to \$1.0 million for the third quarter 2008. The decrease in exploration expenses was primarily due to lower geological and geophysical (“G&G”) costs and settled asset retirement costs, offset by higher lease rental and abandoned property costs incurred in the third quarter 2009.

Depreciation, Depletion and Amortization (“DD&A”). DD&A expense for the third quarter 2009 was \$13.4 million compared to \$13.2 million for the third quarter 2008, primarily due to a higher DD&A rate resulting from the effect of negative price-related reserve revisions offset by lower production in 2009.

Impairment of Oil and Gas Properties. Impairment expense for the third quarter 2009 was zero compared to \$25.8 million for the third quarter 2008. The 2008 impairment relates primarily to our capital investment made in pursuing the Rodessa formation within the Madisonville Field. Negative performance-related reserve revisions, including the abandonment of the Rodessa formation in the Johnston 2U well, triggered an evaluation of the Madisonville Field for impairment purposes. Given the high original cost of drilling and developing the field and the high cost of producing and processing sour gas, combined with lower commodity prices, our evaluation resulted in the recorded costs of this field exceeding the estimated future undiscounted cash flow of the reserves as of the end of the third quarter 2008.

General and Administrative (“G&A”) Expenses. Total G&A expenses were \$3.8 million for the third quarter 2009 compared to \$7.6 million for the third quarter 2008, which includes non-cash stock expense of \$0.3 million (\$0.10 per Mcfe) and \$1.5 million (\$0.29 per Mcfe) for the third quarter 2009 and 2008, respectively. The reduction in G&A expenses is primarily a result of the implementation of cost reduction initiatives during 2009.

Interest Expense. Interest expense was \$6.6 million for the third quarter 2009, compared to \$5.5 million for the third quarter 2008. Total interest expense increased primarily due to higher debt balances and higher interest rates on our second lien credit agreement. Total interest expense capitalized for the third quarter 2009 and 2008 was approximately \$25,000 and \$0.2 million, respectively.

Other Financing Costs. Other financing costs were \$0.4 million for the third quarter 2009 compared with \$0.3 million for the third quarter 2008. These expenses are comprised primarily of the amortization of capitalized costs associated with our credit facilities and to commitment fees related to the unused portion of the credit facilities.

Unrealized Gain (Loss) on Derivative Instruments. Unrealized gain or loss on derivative instruments is the change in the mark-to-market exposure under our commodity price hedging contracts and our interest rate swaps. This non-cash unrealized loss for the third quarter 2009 was \$9.9 million compared with a non-cash unrealized gain of \$88.9 million for the third quarter 2008. Unrealized gain or loss will vary period to period, and will be a function of hedges in place, the strike prices of those hedges and the forward curve pricing for the commodities and interest rates being hedged.

Income Taxes. Our net loss before taxes was \$13.4 million for the third quarter 2009 compared to net income before taxes of \$78.7 million in the third quarter 2008. After adjusting for permanent tax

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differences, we recorded an income tax benefit of \$4.8 million for the third quarter 2009, compared to income tax expense of \$28.5 million for the third quarter 2008.

Dividends on Preferred Stock. Dividends on preferred stock were \$1.2 million for the third quarter 2009 compared with \$1.1 million in the third quarter 2008. Dividends in the third quarter 2009 included approximately \$1.1 million on the Series G Preferred Stock and \$10,745 on the Series H Preferred Stock. Dividends in the third quarter 2008 included \$1.1 million on the Series G Preferred Stock and \$28,000 on the Series H Preferred Stock. Until such time as the Board of Directors declares and pays dividends on our Series G Preferred Stock, dividends shall continue to accumulate. Dividends on our Series H Preferred Stock are declared quarterly by our Board of Directors, and are paid out in Common Stock the following quarter.

Nine Months Ended September 30, 2009 Compared to Nine Months Ended September 30, 2008

Revenues

	Nine months ended September 30,				
	2009	2008	Change		Percent Change
	(in millions, except percentages)				
Revenues:					
Natural gas sales	\$ 55.1	\$ 92.1	\$ (37.0)	)	-40.2%
Crude oil sales	21.5	34.2	(12.7)	)	-37.1%
Natural gas liquids sales	9.1	24.7	(15.6)	)	-63.2%
Product revenues	\$ 85.7	\$ 151.0	\$ (65.3)	)	-43.2%

Natural Gas, Crude Oil And Natural Gas Liquids Sales. Revenues from the sale of crude oil, natural gas and natural gas liquids, net of the realized effects of our hedging instruments, were \$85.7 million for the first nine months of 2009 compared to \$151.0 million for the first nine months of 2008 due to an approximate 20% decrease in production and an approximate 29% decline in realized commodity prices.

	Nine months ended September 30,				
	2009	2008	Change		Percent Change
Sales (production) volumes:					
Natural gas (Mcf)	8,142,588	9,752,667	(1,610,079)	)	-16.5%
Crude oil (Bbl)	264,170	385,458	(121,288)	)	-31.5%
Natural gas liquids (Bbl)	334,303	422,107	(87,804))	-20.8%
Natural gas equivalents (Mcf)	11,733,426	14,598,057	(2,864,631))	19.6%

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Production was approximately 11.7 Bcfe for the first nine months of 2009 compared to approximately 14.6 Bcfe for the first nine months of 2008. On a daily basis, we produced an average of 42,980 Mcfe in the first nine months of 2009 compared to an average of 53,278 Mcfe in the first nine months of 2008. Production volumes decreased primarily due to natural field decline and limited production-enhancing capital expenditure activity in the first nine months of 2009.

	Nine months ended September 30,				
	2009	2008	Change		Percent Change
Average sales prices (after hedging):					
Natural gas (Mcf)	\$ 6.77	\$ 9.44	\$ (2.67)		-28.3%
Crude oil (Bbl)	81.46	88.60	(7.14)		-8.1%
Natural gas liquids (Bbl)	27.19	58.49	(31.30)		-53.5%
Natural gas equivalents (Mcfe)	7.31	10.34	(3.03)		-29.3%

	Nine months ended September 30,				
	2009	2008	Change		Percent Change
Average sales prices (before hedging):					
Natural gas (Mcf)	\$ 3.92	\$ 9.83	\$ (5.91)		-60.1%
Crude oil (Bbl)	52.80	112.98	(60.18)		-53.3%
Natural gas liquids (Bbl)	27.19	58.49	(31.30)		-53.5%
Natural gas equivalents (Mcfe)	4.68	11.24	(6.56)		-58.4%

Natural gas, crude oil and natural gas liquids prices are reported net of the realized effect of our hedging agreements. We realized gains of \$7.6 million on our crude oil hedges and \$23.2 million on our natural gas hedges in the first nine months of 2009, compared to realized losses of \$9.4 million for crude oil hedges and \$3.8 million for natural gas hedges in the first nine months of 2008.

Costs and Expenses

	Nine months ended September 30,			
	2009	2008	Change	Percent Change
	(in millions, except percentages)			
Certain Operating Expenses:				
Lease operating expenses	\$ 13.5	\$ 15.4	\$ (1.9)	) -12.3%
Production and ad valorem taxes	6.1	14.4	(8.3)	) -57.6%
Exploration expenses	2.9	1.9	1.0	52.6%
General and administrative ⁽¹⁾	11.5	13.5	(2.0)	) -14.8%
Operating expenses (cash)	34.0	45.2	(11.2)	) -24.8%
Depreciation, depletion & amortization	41.6	36.0	5.6	15.6%
Share-based compensation ⁽¹⁾	1.9	4.3	(2.4)	) -55.8%
Certain operating expenses ⁽²⁾	\$ 77.5	\$ 85.5	\$ (8.0)	) -9.4%

(1) Total general and administrative costs include share-based compensation on the Consolidated Statements of Operations

(2) Exclusive of impairments and sales.

	Nine months ended September 30,			
	2009	2008	Change	Percent Change
	(in millions, except percentages)			
Selected Costs (\$ per Mcfe):				
Lease operating expenses	\$ 1.15	\$ 1.05	\$ 0.10	9.5%
Production and ad valorem taxes	0.52	0.98	(0.46)	) -46.9%
Exploration expenses	0.24	0.13	0.11	84.6%
General and administrative ⁽¹⁾	0.98	0.92	0.06	6.5%
Operating expenses (cash)	2.89	3.08		